IN THE

Supreme Court of the United States.

OCTOBER TERM, 1928.

No. 129.

UNITED STATES OF AMERICA
v.
BOSTON & MAINE RAILROAD.

On Certificate from the United States Circuit Court of Appeals for the First Circuit.

MEMORANDUM BRIEF FOR THE BOSTON & MAINE RAILROAD ON REARGUMENT.

STATEMENT.

This case is now before the Court upon reargument, pursuant to the Order of February 18, 1929. The Order recites that the Court especially desires assistance of counsel in respect of the following matters:

1. Was there power in Congress to confer jurisdiction upon the Circuit Court of Appeals to review action by the Board of Tax Appeals?

2. Does the Circuit Court of Appeals act as a tribunal of original jurisdiction when considering appeals from the Board of Tax Appeals? If so, may it under Title 28, United States Code, Sec. 346, certify to this Court questions deemed necessary for the proper decision of a pending cause?

3. What has been the practice of taxing officers relative to assessments where, by agreement between the parties, the tax laid upon the income actually received by one of them has been paid by another?

4. Do applicable statutes authorize the taxing officers to estimate total income by adding to the amount actually received by the taxpayer any tax which another has paid thereon under agreement between the parties?

This case originated in the United States District Court for the District of Massachusetts, and hence the first two questions are without application here. Those questions are fully dealt with in numerous briefs filed in Case No. 130 (*Old Colony Trust Company et al., Executors*, v. *Commissioner of Internal Revenue*).

There can be no doubt that upon an appeal from the judgment of a United States District Court the Circuit Court of Appeals acts as a tribunal of appellate jurisdiction, and that a case is presented under Title 28, United States Code, Section 346, in which the Circuit Court of Appeals is authorized to certify any questions deemed necessary for its proper decision.

The questions upon the merits are:

1. The primary question, certified by the Circuit Court of Appeals: whether the payment by the Boston & Maine Railroad, lessee, pursuant to the terms of its lease, of the Federal income taxes assessed against the Fitchburg Railroad Company, lessor, constituted additional taxable income to the latter; and

2. The corollary question: whether if the payment of such tax be regarded as additional taxable income, resulting in an additional or secondary tax, that secondary tax, being equally payable by the lessee, constitutes in turn further additional income to be subjected to a tertiary tax, and so on *ad infinitum* —or whether the first tax paid by the lessee is income to the

lessor, but the secondary tax, though equally payable by the lessee, is not income.

These questions are indicated in the fourth point shown above, upon which the Court has shown a desire for the assistance of counsel. With respect to them reference is respectfully made to the principal brief filed on behalf of the Boston & Maine Railroad in this case.

The third point indicated by the Court in its Order of February 18, 1929—what has been the practice of taxing officers in cases of this type?—has been the subject of much discussion between counsel for the Government and counsel for the taxpayer, since the entry of the Order of February 18, but we regret that we have been unable to come to agreement with the Government as to the facts.

Counsel for the Government in their Memorandum Brief for the United States on Reargument indicate these facts only by reference to their Brief for the Commissioner of Internal Revenue on Reargument in No. 130. In that brief, under "III. Taxes paid by another for the benefit of the taxpayer have consistently been regarded by the taxing officers as additional income to the taxpayer" (p. 28), they make certain statements, based upon a letter dated April 2, 1929, from the Commissioner of Internal Revenue, which is printed as Exhibit C (p. 53) of that brief. We regret that we can not concede the accuracy of those statements in the brief and letter, and feel sure that the Commissioner, who, as a matter of course, must have relied upon information furnished by subordinates, would not have signed said letter if his attention had been called to certain facts within our knowledge as counsel for certain taxpayers, and further facts of which we have been advised by counsel for other taxpayers.

A.

It has not been the Uniform Practice of the Bureau to Treat Taxes Paid, Under Agreement Between the Parties, by One for Another, as Income to the Latter.

The Commissioner's letter refers to Treasury Decision 2620 (Dec. 17, 1917) as the first published ruling on this question. That Treasury Decision was a reprint of the opinion of the Circuit Court of Appeals in *West End Street Railway* v. *Malley*, 246 Fed. 625. That case dealt wholly with *dividends* paid by the lessee to the stockholders of the lessor, and had nothing to do with taxes paid by the lessee. We have shown the distinction between that case and this in our first brief. It constituted no basis for injecting taxes (at least not Federal income taxes) into Art. 102 of Regulations 33, Revised, and Art. 109 of Regulations 45, quoted in the Commissioner's letter (pp. 54, 55). The Bureau applied these regulations to many taxpayers, including those whose taxes were paid (to the extent of the two per cent directed by the statute to be *withheld*) by obligors under tax free covenant bonds. But after this Court denied certiorari in *Duffy* v. *Pitney*, 2 Fed. (2d) 230, the Bureau ceased to apply the theory in tax free covenant bond cases, while inconsistently continuing to apply it in most lessor-lessee cases. The argument urged by the Government in *Duffy* v. *Pitney* was identical with that presented here, and its authorities—*West End Street Railway* v. *Malley* and similar cases—were also the same there and here. But, upon defeat in the courts in its efforts to apply those *dividend* cases to taxes, it reversed itself only with respect to tax free covenant bond cases, and not to the other cases in which it had relied on the same theory and the same decisions.

The Bureau's rulings were never accepted generally by taxpayers—as is evidenced by the fact that this Boston & Maine case involves a tax for 1917—the very first year for which the Government ever applied the theory to taxes—and there are numerous other similar 1917 cases pending in the courts, as well as numerous similar cases covering subsequent years.

The Memorandum of the Committee on Appeals and Re-

view, cited in the Commissioner's letter (p. 55) as A. R. M. 16; C. B. 2, p. 62, is the only *published* ruling on this subject. It deals with a contract for the sale of goods, entered into on July 20, 1917 (distinguishable, as shown in our first brief, from the lease in this case which was made prior to the Sixteenth Amendment). This A. R. M. 16, published in May, 1920, was originally a letter to a certain taxpayer, dated January 6, 1920—changed only to render the corporations concerned unidentifiable. Under date of June 2, 1920, the then Commissioner wrote to the taxpayer's counsel, saying, in part:

> "The theory that the amount of tax paid on behalf of the M Company is income to that company rests upon the assumption that it is an increased amount of compensation. However, in the present case, it is apparent that a literal application of the principles stated in office ruling of January 6th would result in the payment of an aggregate tax grossly disproportionate to the amount to which it attaches in the first instance, and would entail endless accounting readjustments.
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> "It clearly is the intent of the Act to levy a tax upon profits, and not to tax *ad infinitum* the amount received by one party to a contract under an agreement by the other party to reimburse him to the extent of the Federal taxes assessed upon the profits derived from the contract.
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> "That it is held, therefore, the amount of Federal taxes levied upon the profits growing out of the contract between the P Company and the M Company, and paid by the former company in accordance with its agreement with the M Company to pay such taxes, shall not be deducted from gross income of the P Company and shall not be included in the gross income of the M Company, provided the taxable net income of both parties to the contract are subject to the same rate of taxation.
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> "Office ruling of January 6, 1920, is hereby reversed."

We understand that in 1922 or 1923 the Bureau again reversed itself in this case—but at a time when the bankruptcy of the taxpayer rendered it necessary to close the case on the basis of a compromise rather than a computation. Neverthe-

less, between the first and second reversals of position, the same counsel represented another (and a very large) taxpayer with a similar question, and his tax for 1918 was closed on the basis of the language quoted above from the letter of June 2, 1920.

Not having access to the Bureau's records, we can not say how many other instances of inconsistency occurred, but those cited constrain us to deny that the Bureau has been consistent in treating taxes paid by one for another as income to the latter.

At this point we wish to call the attention of the Court to the language of the preamble printed on the cover and on the first page of the Internal Revenue Bulletins. This preamble, as it has been printed since early in 1924, is quoted in full at pp. 7–8 below. At least the first paragraph of it appeared in the Bulletin containing A. R. M. 16. And in that paragraph we find

> "* * * rulings other than Treasury Decisions [A. R. M. 16 not being a Treasury Decision] having none of the force or effect of Treasury Decisions and do not commit the Department to any interpretation of the law which has not been formally approved and promulgated by the Secretary of the Treasury. * * * It is especially to be noted that the same result will not necessarily be reached in another case unless all the material facts are identical with those of the reported case. * * * there can be no assurance that any new case is identical with the reported case. * * *"

We call attention to the fact that no published Treasury Decision or other decision approved and promulgated by the Secretary of the Treasury, other than the ambiguous "Regulations" quoted in the Commissioner's letter, has ever upheld the proposition contended for by the Government.

B.

The Bureau has not been Consistent, Even Since 1923, in the Method of Application of its Theory.

As shown in the Commissioner's letter (p. 56) and in the appendix to our first brief herein,the Bureau seems to have been in doubt as to whether to apply its theory to its logical conclusion, leading in cases of large incomes to monstrous results, or whether to depart from logic and say the first tax is income but the secondary tax thereon is not income—and thus partially to repeal the statute (if their construction of it were sound). The Commissioner's letter (p. 56) says that on April 30, 1923, general instructions were issued to all branches of the Bureau in Memorandum A. R. R. No. 3181 for the purpose of establishing a consistent policy. We shall show that, even if this was done, it did not result in a consistent policy, and that in the light of *published* instructions it could not, and that departure from the A. R. R. was *not* unauthorized.

A. R. R. 3181 was an unpublished decision rendered in the case of the *Providence & Worcester Railroad*, for whom counsel for the taxpayer in the instant case happen also to be counsel. The preamble to the Internal Revenue Bulletins, mentioned above, reads as follows (italics supplied):

> "The rulings reported in the Internal Revenue Bulletin are for the information of taxpayers and their counsel as showing the trend of official opinion in the administration of the Bureau of Internal Revenue; the *rulings other than Treasury Decisions having none of the force or effect of Treasury Decisions and do not commit the Department to any interpretation of the law which has not been formally approved and promulgated by the Secretary of the Treasury.* Each ruling embodies the administrative application of the law and Treasury Decisions to the entire state of facts upon which a particular case rests. *It is especially to be noted that the same result will not necessarily be reached in another case unless all the material facts are identical* with those of the reported case. As it is not always feasible

to publish a complete statement of the facts underlying each ruling, *there can be no assurance that any new case is identical with the reported case.* As bearing out this distinction, it may be observed that the rulings published from time to time may appear to reverse rulings previously published.

"*Officers of the Bureau of Internal Revenue are especially cautioned against reaching a conclusion in any case merely on the basis of similarity to a published ruling,* and should base their judgment on the application of all pertinent provisions of the law and Treasury Decisions to all the facts in each case. These rulings should be used as aids in studying the law and its formal construction as made in the regulations and Treasury Decisions previously issued.

"In addition to publishing all Internal Revenue Treasury Decisions, *it is the policy of the Bureau* of Internal Revenue *to publish all rulings* and decisions, including opinions of the General Counsel for the Bureau of Internal Revenue, *which,* because they announce a ruling or decision upon a novel question or upon a question in regard to which there exists no previously published ruling or decision, or *for other reasons, are of such importance as to be of general interest.* It is also the policy of the Bureau to publish all rulings or decisions which revoke, modify, amend, or affect in any manner whatever any published ruling or decision. In many instances opinions of the General Counsel for the Bureau of Internal Revenue are not of general interest because they announce no new ruling or no new construction of the revenue laws but simply apply rulings already made public to certain situations of fact which are without special significance. It is not the policy of the Bureau to publish such opinions. Therefore, the numbers assigned to the published opinions of the general Counsel for the Bureau of Internal Revenue are not consecutive. *No unpublished ruling or decision will be cited or relied upon by any officer or employee of the Bureau of Internal Revenue as a precedent in the disposition of other cases.* Unless otherwise specifically indicated, all published rulings and decisions have received the consideration and approval of the General Counsel for the Bureau of Internal Revenue."

In the light of the unequivocal prohibition, to all officers and employees of the Bureau, against relying upon any unpublished

ruling as a precedent, how could the Bureau be expected to be consistent in following unpublished A. R. R. 3181? How could any departure therefrom be "unauthorized"? How could the officers of the Bureau obey the mandate of the preamble quoted above and give any effect to A. R. R. 3181?

A. R. R. 3181 is set forth in full—for we think the portions thereof which we italicise may be of interest to the Court in considering the merits of this case:

> "The Committee has had under consideration the appeal of the Providence & Worcester Railroad Company, Providence, Rhode Island, from the action of the Income Tax Unit in including in taxable net income for each of the years 1917 and 1918 Federal taxes payable by the lessee of its road, in adjusting invested capital for the year 1918 according to the method prescribed in A. R. M. 188 and in excluding from invested capital for 1917 Federal taxes payable by the lessee for the year 1916.
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> "Oral hearing has been accorded the appellant's representatives.
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> "The first two questions here presented were previously submitted to the Committee by the Unit with a request for advice as to whether or not the lessor corporation should include in its net income Federal income and profits taxes payable by the lessee corporation and, if so, as to the correct method to be followed in computing such taxes. The Committee, at that time, thoroughly considered both questions and in A. R. M. 188 advised the Unit that such taxes were additional income to the lessor, and prescribed the method to be followed in computing such taxes as follows:
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> > "'The lessor corporation at the close of its taxable year should, without taking into account the amount of income and profits taxes paid in its behalf by the lessee corporation, determine what its gross income and net income are, then compute the amount of income and profits taxes properly assessable against a similar amount of income, accrue upon its books additional gross income in an amount equal to the taxes so computed and include such an amount in its return as additional gross income. The amount of income and profits taxes assessable against the lessor corporation is to be

computed on the amount of net income shown in that return.'

"The Committee realizes that *the method above prescribed results in certain inconsistencies when it comes to adjusting invested capital for a succeeding year, in that surplus is necessarily increased by an amount less than the amount of the tax which is used to reduce invested capital from the date payable to the close of the taxable year.* These inconsistencies are, however, more apparent than real because, *while invested capital is reduced in a greater amount on account of the larger tax prorated, still the income for the preceding year is reduced on account of the lesser tax added to income for that year.* Further than this, *the Committee is not aware of any method which can be laid down as applicable to all cases which will not result in inconsistencies.* The method prescribed, therefore, seems to be the simplest, soundest and the most logical; it is in accordance with the practice of the Income Tax Unit and the Committee recommends that it be adhered to.

"Relative to the third point raised on appeal, the taxpayer contends that it should be allowed to include in invested capital for 1917 the Federal income taxes payable for the year 1916, up to the time those taxes became due and payable in the year 1917. The appellant's books are kept on the accrual method of accounting and the consistent policy of the Bureau has been, when such is the case, to require that income and authorized deductions shall be computed and accounted for on the same basis. Income taxes for 1916 were allowable deductions for that year. Such being the case, these taxes should have been accrued on the books as a liability as at January 1, 1917, and surplus should have been reduced in an equal amount. (See T. D. 2433 and Law Opinion 1059.)

"It is therefore recommended, in the appeal of the *Providence & Worcester Railroad Company*, that the action of the Income Tax Unit be sustained and that the appeal be denied."

To show the Court that the Bureau has not been consistent in following A. R. R. 3181 or the policy therein stated, we can refer to the very case at bar, in which the pyramiding theory was applied. Admitting that the original determina-

tion by the Bureau was made before A. R. R. 3181, why did not counsel for the Bureau, at the trial in the District Court in November, 1927, indicate that the policy of A. R. R. 3181 might be applied, and consent to a partial judgment for the plaintiff? That counsel was an officer of the Bureau of Internal Revenue—a special attorney in the office of the General Counsel of that Bureau.

Another example is a matter of public record in the District Court for the District of Connecticut in the case of *Hartford & Connecticut Railroad Company* v. *The United States*, trial in which has been postponed by consent to abide the decision of this court in the present case. In that case the Treasury Department, by letter to the taxpayer dated November 27, 1922, proposed an additional tax for 1917 in an amount which was computed on the theory of completing the pyramid of taxes—exactly as was done in this case. That taxpayer, for whom counsel for the taxpayer in the instant case happen also to be counsel, exercised the right, conferred by Section 250 (d) of the Revenue Act of 1921, to appeal from the determination of the Railroad Section of the Income Tax Unit. That appeal was in due course assigned to the office of the then Solicitor of Internal Revenue for consideration. Counsel for the taxpayer appeared before the Solicitor's office on July 10, 1923, and argued orally against the imposition of this pyramided tax. Notwithstanding this argument, the Solicitor, by letter of July 19, 1923, three months subsequent to the issuance of A. R. R. No. 3181, advised counsel for the taxpayer in that case that the Commissioner of Internal Revenue had approved his conclusion that "the action of the Income Tax Unit in including in gross income the amount of Federal income taxes paid for the lessor by the lessee of its property should be sustained."

The entire amount of the deficiency proposed in the letter of November 27, 1922, and wholly approved by the Solicitor, was in 1924 assessed and collected, notwithstanding a lesser amount was payable under the formula of A. R. R. 3181. By letter dated April 11, 1927—four years after the alleged establishment of uniformity—the Bureau rejected the taxpayer's

claim for refund of the additional tax. This rejection *in full*, in 1927, of the claim for refund, instead of allowing it in part, was certainly not consistent with the policy now claimed by the Commissioner to have been uniformly applied since 1923.

We could cite other similar instances, but these seem sufficient to show that the Bureau practice certainly has not been consistent since 1923. And, as shown above, in the light of the *published* instructions to Bureau auditors, the inconsistency is certainly *not unauthorized*.

Presumably, the Government's effort to show consistency is for the purpose of finding a basis for an argument that the inaction of Congress, in the light of known rulings, constituted legislative sanction of those rulings. But only one of those rulings was published—and that one under a limitation that it was not binding. *Prospective* Congressional sanction may be presumed for the rule of *West End Street Railway* v. *Malley* with respect to *dividends* constituting income, but there is no basis for *retrospective* Congressional sanction with respect to the proposition that *income taxes* are income, *Shearer* v. *Anderson*, 16 Fed. (2d) 995.

CONCLUSION.

For all the reasons given in our principal brief it is respectfully submitted that the question certified by the Circuit Court of Appeals should be answered in the negative.

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